



Office of the City Auditor

Basin Management Funds Report No. 0804

July 28, 2008

Money paid into the Basin Management Funds is recorded in the correct restricted use accounts, and the City is spending Basin Management Funds consistently with contract terms. Areas for improvement include classifying revenues as liabilities, monitoring revenues for accuracy, issues relating to timeliness of revenue and collection of interest revenue, obtaining and retaining Council and Bureau of Reclamation approval for expenditures, and receiving proper budget authority for expenditures.

CITY COUNCIL

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Wayne Ecton
W.J. "Jim" Lane
Robert Littlefield
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City Auditor**

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July 28, 2008

Honorable Mayor and Members of the City Council:

Enclosed is a report on Basin Management Funds, Report No. 0804.

We would like to thank the Community Services Department, especially Tom Beat, and the Financial Services Department, especially Paula Novacek, for their cooperation during the audit. Their assistance was invaluable during the audit.

As in a number of recent audits, effective contract administration is also a theme of this audit. In our view, planning, monitoring and proactive oversight of contract and contractor performance is important to ensure that the City and its citizens receive the agreed-upon product or level of service. Effective contract administration is two-fold and includes both well-developed terms and conditions in the initial contract, as well as, efficient day-to-day administration of the approved contract. This reduces the risk of non-compliance and helps to safeguard City assets. Citywide efforts such as this fall's Contract Academy will bring needed emphasis to this important duty.

This audit was conducted by Kim Prendergast, CPA, CIA, and Ellie Kim, under the direction of Joyce Gilbride, CPA, CIA.

If you need additional information or have any questions, please contact me at 480-312-7288.

Sincerely,

A handwritten signature in black ink, appearing to read "Brent Stockwell". The signature is fluid and cursive, with the first name "Brent" being more prominent.

Brent Stockwell
Acting City Auditor

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EXECUTIVE SUMMARY

An audit of the City's Basin Management Funds was included on the Audit Plan for the fourth quarter of fiscal year 2007/08 as presented to the Audit Committee on March 27, 2008. The purpose of this audit was to test compliance with requirements under the Cost-Sharing and Land Use Agreement between the City and the Bureau of Reclamation,

Control activities are in place, but could be strengthened to provide greater assurance of compliance or timely detection of non-compliance.

Seven areas for improvement within management of the Basin Management were identified:

- Monies collected through surcharges and mitigation fees are maintained in designated Basin Management Funds; however, management has elected to classify the monies as liabilities rather than as revenues.
- Expenditures were made from the Basin Management Funds without proper budget authority.
- Processes are not in place to ensure that revenues received for the Basin Management Funds are correct or timely.
- In one instance, documentation was insufficient to determine if Bureau of Reclamation approval was obtained prior to expenditure of Basin Management Funds.
- Documentation was insufficient to ensure City Council approval was obtained prior to expenditure of Basin Management Funds.
- Interest was not collected by the City of Scottsdale on a loan that specified interest in its payment terms.
- A loan from the City to the Tournament Players Club was not repaid timely.

Management's proposed actions are outlined in the Action Plan that follows. The complete response is found in Appendix A.

ACTION PLAN

No.	Management Response
1	Monies collected through surcharges and mitigation fees are maintained in designated Basin Management Funds; however, management has elected to classify the monies as liabilities.
	<p>Management Response: <input checked="" type="checkbox"/> Agree</p> <p>Proposed Resolution:</p> <p>Surcharges and mitigation fees collected as Basin Management Funds may not be expended by the City without the expressed written approval of the Bureau of Reclamation. Effective fiscal year 2008-2009, the City will record the surcharges and fees in a deferred revenue account. Revenue and expenditures will be recognized and recorded as approved by Bureau of Reclamation. Recording these transactions as a liability was a decision of professional judgment made given the circumstances at the time and was a more conservative approach.</p> <p>Responsible Party: Contract Administrator Accounting & Tax Audit Director</p> <p>Completed By: August 2008</p>
2	Expenditures were made from the Basin Management Funds without proper budget authority.
	<p>Management Response: <input checked="" type="checkbox"/> Agree</p> <p>Proposed Resolution:</p> <p>Expenses should not have been made from a liability account. Basin Management revenue and expenditures will be included in the City's adopted budget and appropriate budget authority will exist for planned expenditures.</p> <p>Responsible Party: Contract Administrator Accounting & Tax Audit Director</p> <p>Completed By: August 2008</p>
3	Processes are not in place to ensure that revenues received for the Basin Management Funds are correct or timely.
	<p>Management Response: <input checked="" type="checkbox"/> Agree</p> <p>Proposed Resolution:</p> <p>The Contract Administrator will monitor the Basin Management Fund revenues to ensure accurate payments are received in a timely manner in accordance with the contract. In addition, actual Basin Management Fund activity will be monitored as a part of the City's monthly revenue variance analysis.</p> <p>Responsible Party: Contract Administrator Accounting & Tax Audit Director</p> <p>Completed By: August 2008</p>

No.	Management Response
4	In one instance, documentation was insufficient to determine if Bureau of Reclamation approval was obtained prior to expenditure of Basin Management Funds.
	<p>Management Response: <input checked="" type="checkbox"/> Agree</p> <p>Proposed Resolution:</p> <p>One of seven transactions reviewed failed to have appropriate written documentation. The following procedures for acquiring Project and Funding approval from the Bureau of Reclamation (BOR) are in place effective August 1, 2008:</p> <ul style="list-style-type: none"> • Request for project and funding consideration must be submitted in writing from the requesting party to the Contract Administrator. • Requests submitted to the Contract Administrator will be reviewed for details of the project proposal and for appropriateness of funding support from the Basin Management Fund. • If the project and funding request are appropriate for Bureau consideration, the Contract Administrator will draft a letter to the Bureau requesting approval. • Expenditures will not be incurred until written approval from the Bureau is received. • City Council approval will be received as required as identified in #5 below. <p>Responsible Party: Contract Administrator Accounting & Tax Audit Director</p> <p>Completed By: August 2008</p>
5	Documentation was insufficient to ensure City Council approval was obtained prior to expenditure of Basin Management Funds.
	<p>Management Response: <input checked="" type="checkbox"/> Agree</p> <p>Proposed Resolution:</p> <p>The following procedures for allocating funding from the Basin Management Fund approved by the Bureau of Reclamation are in place effective August 1, 2008:</p> <ul style="list-style-type: none"> • Budget authority will exist before expenditures are made from the Basin Management Fund. • When appropriate, City Council approval will be obtained before expenditures are made from the Basin Management Fund. <p>Responsible Party: Contract Administrator Accounting & Tax Audit Director</p> <p>Completed By: August 2008</p>

No.	Management Response
6	Interest was not collected by the City of Scottsdale on a loan that specified interest in its payment terms.
	<p>Management Response: <input checked="" type="checkbox"/> Agree</p> <p>Proposed Resolution:</p> <p>Loan agreements will be invoiced to ensure payment terms are complied with according to the terms of the agreement. In June 2008, we received an interest payment for \$14,970.00. The remaining interest payment due of \$41,180.00 has been invoiced.</p> <p>Responsible Party: Contract Administrator Accounting & Tax Audit Director</p> <p>Completed By: August 2008</p>
7	A loan from the City to the Tournament Players Club was not repaid timely.
	<p>Management Response: <input checked="" type="checkbox"/> Agree</p> <p>Proposed Resolution:</p> <p>The loan has been repaid. The anticipated loan repayment schedule was modified due to the closure of the Champions Course for one year for renovation and redesign. The need to modify the schedule was acknowledged and agreed to with the PGA Tour/TPC Scottsdale by City Manager at the time. Approval was provided, however, written documentation was not formalized.</p> <p>The closure of the Champions Course cut off a revenue stream required to provide the necessary revenue to allow for the original repayment schedule to remain in place.</p> <p>Responsible Party: Contract Administrator Accounting & Tax Audit Director</p> <p>Completed By: August 2008</p>

BACKGROUND

Introduction

On September 30, 1968, Public Law 537 was passed by the 90th United States Congress authorizing construction of the Central Arizona Project (CAP). The construction of the CAP Canal required the acquisition of considerable land for the path of the canal, and the creation of flood detention basins to collect runoff water to protect the canal. To provide flood protection to the cities of Phoenix, Paradise Valley, and Scottsdale, the United States Bureau of Reclamation (BOR) purchased the Paradise Valley Flood Detention Basin (called the Reach 11 area). The Central Arizona Project management plan directed that these acquired lands could only be used for public recreation purposes.

The BOR designated the portion of the Reach 11 area adjacent to Pima Road and to the north side of the Granite Reef Aqueduct in Scottsdale to be developed for public recreational use. The area of development included the areas where the Tournament Players Club (TPC), the Sanctuary Golf Course (Sanctuary), and WestWorld are currently located. In July 1982, the BOR entered into a Cost-Sharing and Land Use Agreement with the City of Scottsdale to manage their property and develop a new public recreation facility on the BOR property, called Horseman's Park (now called WestWorld). In 1985, the BOR entered into a recreational land use agreement for a golf complex, originally called the Scottsdale Golf Complex and now referred to as the Tournament Players Club - Scottsdale.

In 1985, the City of Scottsdale privatized the daily management of Horseman's Park, while committing to construct the new public facility (Sanctuary) on Bureau of Reclamation property. On January 1, 1997, the City of Scottsdale resumed the responsibility for daily operation of the WestWorld facility. In 1998, the original land use agreement signed with the BOR in 1982 was amended to include the Sanctuary Golf Course.

As mentioned above, there are currently two land use agreements that utilize Basin Management Funds: the Cost Sharing and Land Use Agreement (WestWorld Agreement) at WestWorld and the TPC Golf Complex (TPC Agreement). There are also two associated golf course agreements that require payments to the Basin Management Funds, one between the City and the PGA to operate and maintain the TPC - Scottsdale, and the Golf Course Concession Agreement for the Sanctuary Golf Course.

Monitoring Agreements/Oversight

Oversight of the land use and golf course agreements is provided by staff within the Community Services Department and WestWorld. In the past, all of the agreements were monitored by Community Services Department staff.

Cost Sharing and Land Use Agreement (WestWorld Agreement)

There have been eleven amendments to the WestWorld Agreement to date; the most recent occurring in November 2007. The WestWorld Agreement requires the City to administer the facility for public outdoor recreational use, and the BOR must approve all improvements and policies pertaining to the development and operation of the facility. The City is required to maintain books, records, and documents of costs and expenses, and to submit an annual report to the BOR. The table below summarizes amendments to the WestWorld Agreement since 1982.

AMENDMENTS TO WESTWORLD AGREEMENT BETWEEN U.S. BUREAU OF RECLAMATION AND CITY OF SCOTTSDALE		
Amendment Number	Date	Purpose
1	03/14/1984	Increased amount of initial cost-share.
2	02/21/1985	Extended boundary of land under agreement.
3	12/24/1985	Extended term of agreement with 25-year renewal option.
4	09/09/1987	Added 5 acres south of dike at northeast corner of Pima and the aqueduct.
5	11/03/1998	Authorized a Basin Management Fund; set out a requirement for a \$55,000 annual fee to the BOR; and provided cost-sharing funds for improvements at the facility.
6	09/07/1999	Authorized wetlands project at Sanctuary Golf Course and \$10,000 in cost-sharing monies.
7	09/07/1999	Added parcel at the southwest corner of Pima and the canal.
8	09/18/2000	Cost-share of \$175,000 for trailhead construction.
9	05/16/2001	Cost-share for acquisition, planting, and irrigation of plant material (76 trees at facility).
10	04/28/2004	Established new process for approval of fees and granted authorization to implement a ticket surcharge. Surcharge must go into Basin Management Fund.
11	11/06/2007	Increase the administrative fees payable by the City to BOR to \$100,000 each fiscal year. This Amendment also provides for a 5 percent increase each fiscal year thereafter for escalation of costs.

SOURCE: Auditor analysis of documents from Scottsdale City Clerk's Office.

In 1998, Amendment 5 to the WestWorld Agreement established the WestWorld Basin Management Fund (BMF). The BMF is a designated restricted use account that is used to develop, operate, maintain, and/or improve the WestWorld Facility and lands for public recreation. A written request must be submitted to the BOR prior to expenditure of BMF funds. However, according to the BOR, any interest earned on the funds may be spent by the City without restriction.

In Amendments 5 and 10 to the WestWorld Agreement, the BOR specifically set out the following types of revenues to be placed in the BMF:

- All monetary values collected by the City in the form of mitigation fees, and
- Ticket surcharges

These revenues are explained in more detail as follows:

Mitigation Fees

The BOR requires the City to deposit funds it receives in the form of mitigation for the loss of recreation and use of WestWorld into the BMF. For example, when the Arizona Department of Transportation (ADOT) took right of way for construction of the Loop 101 Freeway, the BOR required ADOT to pay into the BMF. To date, Cellular One has also paid mitigation fees into the BMF.

Ticket Surcharges

In 2004, the BOR approved a request from the City to amend the WestWorld Agreement and allow the collection of a ticket surcharge on all events that impose an entrance fee to WestWorld. A fifty cent (\$.50) per ticket surcharge is added to tickets with a price up to \$19.99, and a one dollar (\$1.00) per ticket surcharge is added to tickets with a price greater than or equal to \$20.00. The provision for this surcharge is incorporated into the standard Facility Use License, and revenue collected is recorded in the WestWorld BMF.

The balance of the WestWorld BMF as of March 31, 2008, was \$876,944 including interest earned on the account.

TPC Golf Complex (TPC Agreement)

The two 18-hole public golf courses identified for the TPC Golf Complex in the TPC Agreement have been constructed, and along with certain other land owned by the City, are being operated by the Tournament Players Club of Scottsdale, Inc. and the PGA Tour, Inc. pursuant to a Lease and Management Agreement with the City, to which the BOR is not a party.

The two 18-hole public golf courses include a Stadium Course and the Champions Course. The Stadium Course was designed for spectator viewing and is used for the PGA Tour's FBR Open while the Champions Course, formerly known as the Desert Course, has green fees comparable to municipal courses in the area. The Champions Course also offers reduced fees to residents of Scottsdale.

The City is required to maintain books, records, and documents of costs and expenses, and to submit an annual report to the BOR, similar to that of the Cost Sharing and Land Use Agreement at WestWorld.

The TPC Agreement has been amended several times; the table below summarizes the various amendments since 1987.

AMENDMENTS TO TPC AGREEMENT BETWEEN U.S. BUREAU OF RECLAMATION AND CITY OF SCOTTSDALE		
Amendment Number	Date	Purpose
1	01/09/1987	City is responsible for the acquisition of water necessary for development of the TPC Golf Complex.
2	01/09/1987	Establishes that the only land included in the TPC Agreement is north of the flood detention dikes.
3	01/09/1987	City is responsible for maintenance of dike areas; additional parcels added to the TPC Agreement.
4	10/19/1987	Cost-share with BOR of \$62,500 for desert revegetation, irrigation drip system, and public restrooms.
5	04/17/1995	Basin Parcel conveyed to the BOR and added to the TPC Golf Complex.
6	12/03/1998	Authorizes a Basin Management Reserve Account; set out a requirement for a \$55,000 annual fee to BOR; provided cost-sharing funds in the amount of \$200,000 for construction of a new access road to the Desert Course.
7	05/19/2003	Authorized Princess Improvements (landscaping, decorative walls) to remain on Corner Parcel of Property; supervision, operation and maintenance control of Parcel granted to City; established one time payment of \$250,000 or annual payments of \$12,500 by Princess to the City to be placed in Basin Management Reserve Account (BMRA).
8	05/08/2007	Extends TPC Golf Complex to include Desert Course dike and Desert Course dike golf improvements.
9	11/06/2007	Increase the administrative fees payable by the City to BOR to \$100,000 each fiscal year. This Amendment also provides for a 5 percent increase each fiscal year thereafter for escalation of costs.

SOURCE: Auditor analysis of documents from Scottsdale City Clerk's Office.

In 1994, the City Council passed and adopted Ordinance No. 2632 (Ordinance), which authorized the imposition of a surcharge (Surcharge) of one dollar (\$1.00) per nine holes played on all City owned golf courses. The Ordinance provided that revenues collected through the Surcharge were to be used by the City “to acquire, operate, improve, develop, maintain and enhance real property used for City golf courses and related facilities.”

In 1998, Amendment 6 to the TPC Agreement established a designated fund account, the Basin Management Reserve Account (BMRA), where the Surcharges on rounds of play on the TPC Complex golf courses shall be maintained by the City. This account is a designated account that is restrictively used to “develop, operate, maintain and/or improve” the TPC Complex facility and lands. The BOR requires that restricted revenues must be used to pay for management, maintenance, or improvements at the TPC Complex.

A written request must be submitted to the BOR prior to expenditure of BMRA funds. Exceptions to this process specifically mentioned in Amendment 6 include emergency purchases and acquiring land adjacent to the TPC Complex to provide parking.

Initially, the TPC Agreement required a Capital Reserve to ensure that funds would be available for repairs or improvements. This reserve was to be established with a \$100,000 contribution from the City. Starting with the fourth year of operations, TPC-Scottsdale was required to contribute 2.5 percent of golf course income to the Reserve. The City’s approval was required before funds could be expended. During construction, negotiations eliminated the requirement as a means to reimburse TPC-Scottsdale for monies advanced to complete the facility. TPC-Scottsdale also assumed financial responsibility for future improvements and repairs.

A loan of \$295,800 was made by the City of Scottsdale to TPC-Scottsdale from the Basin Management Fund in September 2003. This loan was to be repaid by approximately January 1, 2007. The loan was repaid in September 2007 and March 2008. This was allowed per a verbal agreement between the former City Manager and the PGA Tour, according to the City’s Special Projects/Contract Manager. Repayment was also to include a minimum interest rate of 5 percent. Interest has not been paid as of June 2008.

In 2003, Amendment 7 to the TPC Agreement authorized Scottsdale Princess Partnership (Princess) to allow improvements such as landscaping, decorative walls and other improvements, together referred to as the Princess Improvements to remain on a BOR parcel of land referred to as the Corner

Parcel. This parcel of land is fully described in Exhibit A to Amendment 7. In approximately 1987, improvements were made on the Corner Parcel without a signed agreement with the BOR. Amendment 7 allows the Princess Improvements to remain on the Corner Parcel. This amendment outlines that Princess shall make a one-time payment of \$250,000 or annual payments of \$12,500 for twenty years to the City to be deposited into the Basin Management Reserve Account (BMRA) for allowing the improvements to remain on the Corner Parcel. Princess has chosen to make the annual payments.

The balance of the TPC Golf Complex Basin Management Reserve Account as of March 31, 2008, was \$673,179 including interest earned on the account.

Golf Course Concession Agreement (Sanctuary Agreement) at Sanctuary Golf Course

In addition to the revenues required by the BOR in the land use agreements, a portion of the revenue received from the Sanctuary Agreement is also deposited in the BMF. There is no requirement by the BOR to place any of this revenue in the BMF because the BOR was not a party to this contractual agreement but, once recorded there, the revenue becomes subject to the same restrictions.

In December 1996, the City licensed a portion of the WestWorld site and an adjacent Supplemental Parcel of land to Capital Realty Corporation (Licensee) to be developed into a "first class public golf course" – currently operated under the name Sanctuary Golf Course at WestWorld (Sanctuary). The portion of the WestWorld site and the Supplemental Parcel are referred to as the License Area. The Licensee agreed to construct the golf course and open it for business no later than December 31, 2000.

Additionally, the Licensee agreed to collect one dollar (\$1.00) per nine holes of golf purchased plus 2 percent of gross sales as a Basin Management Fee. This money is payable to the City quarterly. The percentage rate was to increase to 4 percent of gross sales upon refinancing or repayment of construction liens or after the tenth anniversary of the lease. The tenth anniversary of the lease was December, 2006. According to the Special Projects/Contracts Manager, the percentage rate increased starting the first quarter of 2007, with the first payment expected to be received in April 2007. The full payment for the first quarter of 2007 was received in September 2007.

The Basin Management Fee is to be used only to pay the costs of constructing, repairing, and replacing capital improvements and other permanent improvements that benefit the License Area.

In addition to the Basin Management Fee, the Licensee is also required to remit a use fee calculated as 2 percent of gross sales for each calendar quarter. These funds are placed in the City's General Fund rather than the Special Programs Fund where BMF revenues are recorded. Although this use fee does not require the BOR's approval prior to spending, expenditures must still be spent for activities tied to facility operations.

The balance of the Sanctuary Basin Management Fund as of March 31, 2008, was \$773,306, including interest earned on the account.

Accounting Treatment

Staff in the Financial Services Accounting Division has historically recorded BMF revenues in the following general ledger accounts:

- 24144 WestWorld Basin Management Fund
- 24146 TPC Basin Management Fund
- 24148 Sanctuary Basin Management Fund

These are liability accounts that fall under the heading of Security Deposits Payable in the City of Scottsdale Chart of Accounts. In addition to recording the revenue in liability accounts, accrued interest on the balance is also recorded there. According to Accounting Management, the revenue and interest are recorded as a liability because they consider the money to be held for the BOR and because the money cannot be spent without the BOR's approval.

According to staff in the City Attorney's office, in the past they have taken the position that Basin Management Funds are owned entirely by the City, subject only to a contractual promise by the City to get BOR approval to spend it.

The table on the following page shows the activity posted to the BMF from inception through March 31, 2008. The negative interest earnings for TPC are discussed further on page 13.

**Basin Management Fund Activity
Inception Through 03/31/08**

	<u>WestWorld</u>	<u>Sanctuary</u>	<u>TPC</u>
<u>Sources:</u>			
ADOT	\$ 957,350	\$ -	\$ 478,675
BOR Reimbursement	62,806	-	-
BOR Wire Transfer	131,671	22,000	-
Cellular One	180,800	-	-
Contribution TPC/Desert Course	-	-	170,000
FY 06/07 Corrections/Accruals	15,796	65,303	24,821
Golf Course Surcharge	-	979,989	1,520,306 ¹
Interest Earnings	520,809	125,373	(43,078)
MMR 99 CFD	26,200	-	-
Office Rental Fees	29,400	-	-
Princess Walls Repayment	-	-	12,500
Sanct/Tree Correction	185,000	-	-
Sewer Line Lease Pymt	17,500	-	-
Thompson Peak Pkwy	1,375,000	-	-
Thunderbirds Contribution	-	-	80,000
Ticket Surcharges	93,310	-	-
Total Sources	\$ 3,595,642	\$ 1,192,665	\$ 2,243,224
	<u>WestWorld</u>	<u>Sanctuary</u>	<u>TPC</u>
<u>Uses:</u>			
Audobon Society	\$ 41,292	\$ -	\$ -
Bunker Project	-	173,700	-
Fence/Landscape	75,000	-	-
Land Purchase	443,951	-	-
Loan to TPC for Stadium & Bridge	-	-	295,800
Promo Video	3,065	-	-
Restroom Upgrades	-	91,059	-
Sanct Impv/Tree Reloc	137,000	154,600	30,400
Show Office	40,000	-	-
TPC Desert Hole #8	-	-	98,746
TPC Desert Course Greens	-	-	170,000
TPC Entry Features	-	-	168,940
Xfer to CIP Lake Repairs	-	-	250,000
Xfer to CIP - Desert Course drainage	-	-	105,000
Xfer to Debt - MPC Land Acquisition	-	-	451,159
Xfer 98/99 ADOT to TPC	478,675	-	-
Xfer to CIP - ADOT AGA	72,188	-	-
Xfer to CIP - Master Plan	52,526	-	-
Xfer to CIP - Water System	1,375,000	-	-
Total Uses	\$ 2,718,698	\$ 419,359	\$ 1,570,045
GL Balance at 03/31/08	\$ 876,944	\$ 773,306	\$ 673,179

¹ Amount transferred to Basin Management Fund after \$200,000 annual debt payment for TPC land.

SOURCE: Auditor analysis of general ledger activity for accounts 24144, 24146, and 24148.

OBJECTIVES, SCOPE, AND METHODOLOGY

This audit was proposed to determine if:

- Money paid into the Basin Management Funds is recorded in the correct restricted use accounts.
- The City is spending Basin Management Funds in a way that is consistent with terms of the Cost Sharing and Land Use Agreements with the Bureau of Reclamation for WestWorld and the TPC Golf Complex, as well as the Sanctuary Golf Course Concession Agreement.
- Use of revenues from the Basin Management Funds is in compliance with State of Arizona budget and expenditure laws.

To complete the work we:

- Obtained and reviewed applicable state and City policies.
- Reviewed selected documents/transactions for the Basin Management Funds to determine if:
 - Accounts were segregated from each other and other City funds.
 - Expenditures were for the appropriate purpose.
 - Expenditures were properly approved by BOR prior to expenditure.
 - Expenditures were properly approved by City Council prior to expenditure.
 - Loans were made to other parties and if they were properly authorized.
 - Any records were missing.
 - Available funds were overspent.
 - There was adequate oversight of expenditures.

We interviewed various individuals, including but not limited to:

- Special Projects/Contract Manager for Community Services
- Financial Services staff
- Bureau of Reclamation staff
- WestWorld General Manager
- Community Services General Manager

Prior Audit Work

We reviewed recommendations made in previous audits (Tournament Players Club, December 1991 and WestWorld – Compliance with Cost-Sharing and Land Use Agreement, January 2006).

The recommendations within these two audits did not specifically apply to the Basin Management Funds. However, one issue raised in the January 2006 audit report warranted additional work. The TPC-Scottsdale borrowed money from the Basin Management Fund to use as its matching funds for projects undertaken at the facility. The question was raised as to whether such a loan was appropriate and whether the BOR approved this arrangement.

Current Audit Work

The following conditions were noted and discussed with management, but excluded from the body of the report:

- Interest earned on Basin Management Funds is recorded in the designated liability account; however, the agreements are silent on the subject of interest. According to the City's primary contact at the BOR, any interest earned on the funds may be spent by the City without restriction.
- Negative interest was recorded to the TPC liability account in fiscal years 2001/02, 2002/03, 2003/04, 2004/05, and 2005/06, due to negative fund balances.
- Contractual agreements with the TPC-Scottsdale and Princess were not reflected as receivables in the City's financial records.
- One-half of the mitigation payment received from ADOT was transferred to the TPC Basin Management Fund nearly eight years after the original receipt was made to the WestWorld BMF.

At the conclusion of the background and information gathering, we developed a Risk Matrix depicting the risk of undetected non-compliant activity in relation to management developed controls.

Audit work was conducted in accordance with generally accepted government auditing standards as they relate to expanded scope auditing in a local government environment and as required by Article III, Scottsdale Revised Code, Section 2-117, *et seq.* Generally accepted government auditing standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Survey work took place in April and May 2008, and fieldwork was completed in June 2008, with Kim Prendergast, CPA, CIA, CGFM, and Ellie Kim conducting the work.

EVALUATION OF MANAGEMENT CONTROL

Control activities are in place, but could be strengthened to provide greater assurance of compliance or timely detection of non-compliance.

A sufficient control structure should exist to provide assurance of compliance with appropriate statutory regulations. To be considered sufficient, the following elements should be present:

- **Control Environment** - management is aware of the need for a control system and communicates this need with an attitude and awareness that sets the tone for the organization.
- **Risk Assessment** - relevant risks that impact compliance are identified, evaluated, and used as the basis for determining how to manage risk.
- **Control Activities** - policies and procedures are developed and documented.
- **Information and Communication** - usable, relevant information is captured and exchanged in a form and time frame that allows employees to effectively carry out their duties.
- **Monitoring** - periodic assessments of the control structure are undertaken to identify what is working and what needs to be improved or modified.

Results of interviews conducted with Community Services staff indicate the internal control structure over the Basin Management Funds process could be strengthened through:

- Having written procedures in place.
- Analyzing and reviewing backup documentation submitted with payments.
- Proper segregation of duties.
- Exercising the right to audit records at TPC and Sanctuary Golf Courses.

AREAS FOR IMPROVEMENT

1. Monies collected through surcharges and mitigation fees are maintained in designated Basin Management Funds; however, management has elected to classify the monies as liabilities.

Criteria: Amendment 5 to the WestWorld Cost Sharing and Land Use Agreement with the BOR which states that “all monetary values collected by the City, in the form of mitigation....shall be maintained by the City in a designated fund account, which shall constitute a Basin Management Fund.”

Amendment 10 to the WestWorld Cost Sharing and Land Use Agreement with the BOR implementing a ticket surcharge and requiring that surcharge go into the Basin Management Fund.

Amendment 6 to the TPC Golf Complex Agreement with the BOR which states that “Basin Management Fees collected by the City in the form of surcharges on rounds of play on the golf courses shall be maintained by the City in a designated fund account.”

Condition: City staff established Basin Management Funds as liability accounts.

Cause: City staff believed the arrangement with the BOR posed a liability situation.

Effect: Revenue and expenses have been misstated as liability accounts within the City's financial statements.

2. Expenditures were made from the Basin Management Funds without proper budget authority.

Criteria: According to the City of Scottsdale fiscal year 2007/08 Budget Book, Arizona State law requires a balanced budget which is all-inclusive. Arizona Revised Statute (ARS §42-17151) defines a balanced budget as follows:

Fix, levy and assess the amount to be raised from primary property taxation and secondary property taxation. This amount, plus all other sources of revenue, as estimated, and unencumbered balances from the preceding fiscal year, shall equal the total of amounts proposed to be spent in the budget for the current fiscal year.

Also according to the Budget Book, under Arizona State law, all-inclusive means if an item is not budgeted (i.e., does not have an appropriation), it cannot legally be spent during the fiscal year.

Condition: In six of seven transactions reviewed, existence of budget authority was not present. In one of seven transactions reviewed, the revenue was transferred to a Capital Improvement Project (CIP) account and expended utilizing a CIP project number.

Cause: City staff expended funds directly from liability accounts.

Effect: Expenditures were made without budget authority.

3. Processes are not in place to ensure that revenues received for the Basin Management Funds are correct or timely.

Criteria: First Amended and Restated Golf Course Agreement No. 960215A for the Sanctuary Golf Course entered into December 30, 1996, states that Sanctuary shall pay to the City of Scottsdale:

...two percent of Gross Sales calculated for the quarter. Upon repayment or refinancing of any construction lien for construction of the Project, but in no event later than the tenth annual anniversary of this Agreement, the percentage mentioned in the preceding sentence shall be increased from two percent to four percent.

Condition: The Basin Management Fee percentage increased from 2 percent to 4 percent of gross sales effective January 1, 2007, however the payments from Sanctuary did not increase accordingly. The Quarterly Basin Management Fees for the first and second quarter of 2007 submitted to the City of Scottsdale by Sanctuary Golf Course were underpaid by \$39,490.88. A correcting payment was received in September 2007, increasing the fees paid to the City to 4 percent of gross sales.

Cause: Inadequate oversight of Basin Management Fund revenues.

Effect: The City was shorted \$39,490.88 in revenue in fiscal year 2006/07 for the first and second quarter 2007 Basin Management Fee payments. The revenue was posted in fiscal year 2007/08 when the correcting payment was made.

4. In one instance, documentation was insufficient to determine if Bureau of Reclamation (BOR) approval was obtained prior to expenditure of Basin Management Funds.

Criteria: Amendment 5 to the WestWorld Cost Sharing and Land Use Agreement with the BOR which states a written request must be submitted to the BOR prior to expenditure of BMF funds.

Amendment 6 to the TPC Golf Complex Agreement which states a written request must be submitted to the BOR prior to expenditure of Basin Management Funds. Exceptions include emergency purchases and the purchase of land adjacent to the TPC Complex for parking.

Amendment 1 to the Golf Course Concession Agreement (Sanctuary) states that, with the approval of the BOR, the City “shall use the Basin Management Fee only to pay the costs of constructing, repairing, and replacing capital improvements and other permanent improvements” benefiting the golf course.

Condition: BOR approval prior to expenditure was not documented or retained in one of seven Basin Management Fund transactions reviewed.

Cause: Inadequate oversight of Basin Management Fund expenditures.

Effect: Expenditures may have been made without BOR approval, or in conflict with BOR agreements.

5. Documentation was insufficient to ensure City Council approval was obtained prior to expenditure of Basin Management Funds.

Criteria: City of Scottsdale Procurement Code section 2-201 Award of Contract states “The City Council shall award all contracts for construction and professional services exceeding the formal procurement limit set forth in Sec. 2-185(B). All other contracts exceeding the formal procurement limit shall be awarded by the Director.”

City of Scottsdale Procurement Code section 2-185(B) states that “Procurements of over twenty thousand dollars shall be made by formal procedures.”

Condition: City Council approval prior to expenditure was not documented or retained in three of seven Basin Management Fund transactions reviewed, all of which exceeded the formal procurement limit.

Cause: Inadequate oversight of Basin Management Fund expenditures.

Effect: Expenditures may have been made without City Council approval.

6. Interest was not collected by the City of Scottsdale on a loan that specified interest in its payment terms.

Criteria: September 9, 2003, letter from United States Department of the Interior to City of Scottsdale Special Projects/Contracts Manager approving the \$295,800 loan for the TPC Complex with the understanding that the repayment format and schedule included in the August 29, 2003, letter discussed below are adhered to.

August 29, 2003, letter from City of Scottsdale Special Projects/Contracts Manager to Bureau of Reclamation, which specifies that the repayment for the requested \$295,800 loan will be repaid by approximately January 1, 2007. The letter also states repayment will include "a minimum interest rate of five percent and will adjust appropriately if interest rates increase."

Condition: Interest was not paid by the Tournament Players Club in conjunction with the repayment of the loan.

Cause: City staff did not require interest to be paid on the repayment of the loan.

Effect: The City lost out on revenue of up to \$14,790 per year at 5 percent from when the loan was issued in September 2003, to when it was paid back in September 2007 and March 2008.

7. A loan from the City to the Tournament Players Club was not repaid timely.

Criteria: September 9, 2003, letter from United States Department of the Interior to City of Scottsdale Special Projects/Contracts Manager approving the \$295,800 loan for the TPC Complex with the understanding that the repayment format and schedule included in the August 29, 2003, letter discussed below are adhered to.

August 29, 2003, letter from City of Scottsdale Special Projects/Contracts Manager to Bureau of Reclamation, which specifies that the repayment for the requested \$295,800 loan will be repaid by approximately January 1, 2007. The letter also states repayment will include “a minimum interest rate of five percent and will adjust appropriately if interest rates increase.”

Condition: The loan to the Tournament Players Club, in the amount of \$295,800, was not repaid until September 2007 and March 2008, at least eight months after the estimated pay back date of January, 2007.

Cause: City staff did not require prompt repayment of the loan.

Effect: The City lost the ability to use \$295,800 in Basin Management Funds for a minimum of eight months while waiting for repayment.

APPENDIX A – MANAGEMENT RESPONSE

July 28, 2008

TO: Brent Stockwell, Acting City Auditor

FROM: Debra Baird, Community Services General Manager

RE: Basin Management Fund – City Audit Report No. 0804

The attached action plan is in response to Audit No. 0804 relating to the Basin Management Fund. Prior to the compilation of the final audit, staff has initiated steps or completed changes to correct the findings based on the preliminary memos provided by your office.

As part of our evaluation of responses, we remained mindful that internal controls must be viewed from a cost/benefit perspective from the organizational standpoint, given the limited resources and staff available to establish, maintain and enforce the controls.

We want to thank you and your staff for your efforts on this audit.

cc: John Little, Acting City Manager
Neal Shearer, Assistant City Manager
Craig Clifford, Financial Services General Manager, Acting City Treasurer
Brian Dygert, West World General Manager
Richard D. Chess, Accounting & Tax Audit Director